VISTRA

Navigate Tax Pitfalls with European AIFs

When looking to structure a fund to raise capital from European investors, tax is one of the most important considerations. However rather than being a minefield of regulation European domiciles can offer a variety of options that will provide efficiency, speed to market and regulatory stability to fit most global investors.

The lack of international tax rule harmonization creates a significant degree of complexity when looking at launching funds to attract international investors. Many managers previously shied away from establishing European platforms due to this complexity; however, the growing sophistication of alternative investment structures – along with evolving tax and regulatory clarity and stability, allied with a growing pool of new investors allocating to alternative assets – means that the time is ripe.

Establish a Flexible Alternative Investment Fund

Europe offers an attractive pool of sophisticated investors and investment targets as well as a multitude of domiciles that can meet the needs of managers of funds in virtually all asset classes, fund structures and fund objectives.

The goal of any fund manager eying European expansion is the successful creation of an adaptable investment platform that does all the following:

- Establishes regulatory and tax compliance
- Provides tax neutrality and transparency
- Offers access to investment targets
- Attracts new investors
- Streamlines operations
- Retains current investors
- Diversifies investor base
- Offers privacy and security

Shifting Regulatory Environment

The constantly evolving regulatory environment makes that goal a challenge. The Organisation for Economic Cooperation and Development's (OECD) created Base Erosion and Profit Shifting (BEPS) regulation that was aimed at creating global tax accountability. BEPS provisions are designed to close loopholes in tax rules that undermine the integrity and fairness of tax systems. They prevent companies from legally avoiding tax through various manoeuvres – including inter-company transactions and entity structures with inadequate substance and structures that previously were created purely for tax avoidance or used to lower taxable profits. These regulations require that entities and the transactions they enter into demonstrate economic substance to justify receiving benefits specific to the domiciles in which they operate. BEPS provisions are being embedded into local regulation across the globe meaning that funds must meet substance requirements and comply with base erosion provisions in the jurisdictions in which they operate.

In the U.S. tax reform headlines focused on lower corporate tax rates but other changes under review aren't so welcome within the alternative fund space. The potential for additional U.S. tax moves in the near term, especially around limits on interest deductibility, carried interest rules and curbs on losses, impacts fund managers and their funds. Like ripples in a pond, U.S. tax reform is prompting other jurisdictions to re-examine their tax regimes.

Uncertainty surrounding Brexit negotiations muddies the picture as it establishes a new regulatory framework that facilitates greater investment opportunities. This disruption could have impact for its near neighbours in the Channel Islands, Luxembourg and Ireland as they may adjust their position to maintain competitive positioning.

When considering all the tax driven regulatory environment it is key to execute with consideration to the Alternative Investment Fund Managers Directive (AIFMD). The directive harmonizes a supervisory framework by using passporting of funds for distribution across multiple jurisdictions and provides consistent safeguard provisions enhancing consumer protection, lowering overall investment risk.

Creating Solutions

In looking at creating a fund against the backdrop of this regulatory environment a key theme is to establish alignment of investor, structure and investment. Only by understanding the position of your target investor and the target investments as determined by the investment strategy can you model the impact from different fund structures and domiciles. A request to design a structure to attract all investor types in a go anywhere investment strategy will produce a myriad of options and incur a lot of advisory fees before any capital is raised.

Operational practicalities must be taken into account when structuring for tax. The tax and regulatory landscape is complex, so it important to ensure that whatever tax structure is deemed most appropriate by your accountants and tax attorneys, it should be reviewed by the administration team for operational efficiency. Choosing a structure based completely on tax considerations may set your fund up for a high degree of operational complexity increasing costs and possibly nullifying the tax savings. In addition, it can become a challenging customer experience especially regarding reporting.

Selecting Jurisdictions

Multiple European domiciles offer flexible, adaptable, transparent and efficient tax and regulatory frameworks to establish funds that can be distributed to investors across Europe and the globe. These domiciles provide consistent governance approaches that meet OECD substance requirements while providing speed-to-market.

For every need, the large variety of European domiciles offers a specific, targeted solution. For example, Luxembourg is a key entry point for international capital into Europe as well as being a common location selected for funds intended to be broadly distributed across Europe. Large investors who want to hit the ground running find its robust regulatory backbone, flexibility of investment vehicles and continued post-Brexit access to Europe compelling advantages. Other locations such as Jersey and Guernsey can offer more cost-effective domiciles for specific investor / investment combinations. These Channel Islands jurisdictions are frequently chosen by international investors with UK property portfolios. Guernsey, a crown dependency of the U.K., creates its own laws and regulations and is establishing itself as a leading domicile for "Green Funds".

Other jurisdictions such as the Netherlands and Ireland also offer a tax and regulatory framework targeted at alternative investment funds so there is no shortage of options to explore.

With tax regulations constantly evolving keeping a close eye on tax updates from your service providers is critical to making sure you have the most up to date information upon which to base a domicile decision. It is likely Brexit will have a significant impact on the current landscape especially for domicile decisions for funds involving UK investors or assets.

In addition to tax environment, speed to market, operational efficiency, and the ability to market the desired jurisdiction are all critical considerations in jurisdiction selection.

Consider Europe

To expand into Europe successfully, it's important to affiliate with the right partners. Operational and tax experts in the European alternative investment market are well positioned to guide you in the required steps:

- Identifying the target investor base for your compelling investment strategy
- Matching structure with investment objectives and investor base
- Locating the most suitable domicile
- Determining the best operational structure
- Expediting the fund's time to market

European domiciles are responding to the challenges faced by alternative investment managers with many new solutions. No matter what your investment objective is, there is a jurisdiction in Europe that can provide you with a home base for growth.

If you would like to discuss how Vistra can support your launch of funds in Europe or any one of our supported locations, please contact Malcolm Pobjoy using the details below.

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